

Covering Credit Bulletin, September 2008

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This Month's Topics:

- Collection Tools and Tips
- Comments on Credit Outsourcing
- Advantages and Disadvantages of Sharing Credit Limits with Customers
- The Risks of Selling to a Bankrupt Debtor
- Questions and Answers
- Humor in Collections

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Collection Tips and Tools

Here are ten tips for this month:

- Flag accounts for special attention when you find that the debtor makes unnecessary requests for supporting documentation such as copies of their purchase orders, proof of delivery, or duplicate invoices.
- Flag accounts with irregular or erratic payments for more frequent collection calls and more frequent credit file updates.
- Flag marginal or high risk accounts so that only specific people are authorized to release orders or increase the credit limit.
- Flag new accounts for special attention so that they are called immediately if their first order goes past due. Some new accounts test creditors to determine how attentive they are to payments being received on time. Addressing this issue early in the business relationship can prevent more serious payment problems in the longer term.
- Flatly reject an unreasonable payment proposal made by the debtor. Always consider the customer's proposal as an invitation to negotiate, rather than their best and final offer. Also remember that the customer's first offer is usually their worst offer.
- Follow the 80/20 rule when planning your collection calls. In most companies, 80 percent of problems involve 20 percent of active customers. If you focus 80% of your time on the most important 20% of your customers, you will achieve far more than dividing your time equally among all open accounts.
- Follow up on open deductions in the same way as you would follow up on a past due invoice once you have provided written documentation to the customer supporting the fact that the deduction must be repaid.
- Call customers that do not or will not send payment to your lockbox remittance address. Recognize that some customers know that if they remit payment to a lockbox, they lose mail and processing float. As a result, they may initially refuse to

send payment to the appropriate lockbox until and unless you contact them by phone and reach agreement about where payments must be sent.

- For larger invoices, consider sending a friendly reminder letter a week or two before the invoice comes due, and follow up by phone to make certain that the invoice is scheduled for payment a few days before the invoice comes due.

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Advantages of Sharing Information about Credit Limits with Customers

Some companies tell customers their credit limit. Many do not. The question of whether or not to do so is a topic about which there can be honest disagreements. Here are some advantages and disadvantages of sharing credit limits with customers:

- By doing so, the credit department has the opportunity explain what would be required to increase the line
- Sharing this information may cause some customers to believe their credit limit is cast in stone
- By addressing this issue proactively, the credit department is able to deflect criticism if orders must be held because the customer is over the established credit limit
- Some customers will be offended irrespective of how large a credit limit is established for the company
- Notifying the customer of their credit limit may prompt a discussion about what information or documentation would be required to increase the credit limit.
- The creditor company's credit department may not be given the opportunity to discuss how the credit limit might be increased. Instead, the customer or applicant may simply offer its business to a competitor willing to offer a higher credit limit.
- Sharing the credit limit makes it less likely the creditor have to reject an order based on credit limit considerations.
- A credit limit is not the maximum amount that a creditor is willing to offer in open account credit. It is simply the maximum the creditor can offer based on the information currently on file.

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Questions and Answers

Question: What is a judgment lien?

Answer: A judgment creditor (meaning a creditor that has received a judgment against a debtor in a court with jurisdiction to hear the case) obtains a judgment lien on the judgment debtors real property by recording an Abstract of Judgment in the office of the County Recorder in the county in which the real property is located.

Q. Can I forward the Bulletin each month to my subordinates and to my industry credit group?

A. Absolutely.

Q. What is a Preferential Transfer?

A. The US Bankruptcy Code defines a preferential transfer (sometimes called a preference or preference payment) as including almost every transfer or payment made by an insolvent debtor company during the preference period. The preference period is generally within 90 days of the bankruptcy filing date. .

Q. Here is a follow up question: What does the ordinary course of business defense involve as it relates to preferences?

A. Basically, it involves a debt incurred in the ordinary course of business and payment received within the ordinary course of business between the seller and buyer.

Q. What is an assignment for the benefit of creditors, and how does this differ from a composition agreement?

A. An Assignment for the Benefit of Creditors is an out of court liquidation of the assets of a company in which a third party acting in a fiduciary role takes title to the assets of a company and liquidates (sells) them in a manner that benefits creditors. A composition agreement is a formal agreement or arrangement between a debtor company and its creditors. It differs sharply from an Assignment to the extent that the trustee or fiduciary does not take title to the assets of the debtor and because a composition agreement usually requires the approval of a high percent of unsecured creditors.

Q. Here is a follow up question: What are the advantages or disadvantages of a bankruptcy compared to an out of court settlement?

A. This question is too complex to answer briefly, but the bankruptcy code does provide rules under which creditors or their attorney can systematically search for assets and examine transactions (payments) or other transfers of assets made by debtors in the weeks and months prior to the bankruptcy filing.

Q. What is a compilation financial statement?

A. Compilations are reviews that do not involve or require the CPA firm to perform any tests on the accuracy of the financial information being presented. Therefore, the CPA cannot and will not offer any opinion about to the accuracy of the customer's financial statements.

Q. Can you reprint your bankruptcy checklist?

A. Here it is:

- Print an account statement
- Reprint copies of all open invoices
- Order proof of delivery on all open invoices

- Send a reclamation demand on all 'qualified' shipments
- Review payments received from the debtor within 90 days of the bankruptcy filing date to determine the potential amount of preference claims
- Calculate how much product was shipped to this customer in the 90 days prior to the filing date and determine exactly when it was shipped
- Check for personal guarantees and if you find one contact the guarantor to demand payment
- If you are a secured creditor, contact an attorney to discuss your rights and your options
- Promptly review every document received from the Court or the debtor
- Promptly file your Proof of Claim and include copies of supporting documentation and sign it
- Follow up to confirm that your Proof of Claim was filed
- Determine under what terms and conditions you will sell to the bankrupt debtor
- Set up a new account – a separate account – for post petition sales

Q. By the time you publish this, the issue may be mute...but here goes. I met recently with a customer who told me they are planning to file for bankruptcy protection and because they want to do business with us after the filing, they offered to return inventory they have on hand of ours to pay down the debt. Is accepting the return lawful? Is it ethical?

A. I am not comfortable commenting on the ethics of this situation. I am not an attorney and cannot offer legal advice, but in my opinion accepting the return of your inventory would be a preferential transfer --- meaning you may have to return it.

Comments on Credit Outsourcing

The new mantra for business involves concentrating on core competencies, and looking to try to outsource non-core functions including --- you guessed it --- the credit and collection functions. Many companies are willing to consider outsourcing as a tool to reduce costs, improve the quality of credit decisions, and accelerate the collection process as well as the process of evaluating new applicants. Credit professionals should be concerned, and to be aware of this potential risk. Why? Because much of the work performed by the credit department is routine, and can be easily duplicated by an outside service.

What should you know? In my opinion, it may be able to outsource routine collections, but complex problems requiring research and documentation cannot be outsourced without help on the inside --- complicating the process and reducing the savings. Also, the process of establishing credit limits and releasing orders requires a great deal of insight about the company's tolerance for risk. It is difficult to envision how this role could be outsourced easily.

The Risks of Selling to a Bankrupt Debtor

It has become relatively common for companies that file for bankruptcy protection to ask that creditors will sell to them on open account terms while the company is in Chapter 11 bankruptcy. One advantage of doing so involves the possibility of offsetting some the pre-petition losses with post petition profits. One serious risk associated with selling to a bankrupt company is the possibility that the company will fail while in Chapter 11. If this happens, a creditor may suffer a loss of both its pre-petition debt in addition to any money owed post-petition. It is important to remember that less than 50 percent of companies that enter Chapter 11 bankruptcy successfully complete the process and emerge from bankruptcy protection.

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Humor in Collections

Some trade creditors use humor as part of the collection process. The idea behind using humor in collections involves making your collection efforts memorable. Proponents of the use of humorous messages, labels, reminders, stamps and stickers used on collection correspondence hope that if correspondence is noticed it will be paid. The use of humor is only effective in a limited number of situations. For example, humorous collection notices would be unlikely to work with a chronically tardy or delinquent customer. In my opinion, collecting a past due balance is a serious matter. I believe that humor sends a message that the past due balance is trivial or of limited importance, and therefore that the creditor company is not particularly serious about being paid - meaning that payment can be delayed even longer without fear of serious consequences.

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